

## Comments on Advanced Notice of Proposed Rulemaking for Part 704”

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This is global event, not one that was expected or might have been anticipated to this extent. I believe the corporate's operated in good faith.

I belief the NCUA needed to act as they did in preserving the Corporate Credit Unions place in the credit union structure.

### **Payment System**

1. The Corporate Credit Union is needed to help with the payment and settlement system.

### **Liquidity and Liquidity Management**

1. The Corporate Credit unions help the real persons credit union with our liquidity management.
2. The corporate's are the PFI of most credit unions.

### **Field of Membership Issues**

**The “Preferred Corporate” alternative** – A more practical alternative to the “Geographic FOM” approach is to allow each credit union to pick their primary corporate, regardless of location. This approach would involve the following:

Require perpetual membership capital for a credit union to obtain services from a corporate

Standardize capital requirements so that corporates do not compete over credit unions by lowering required capital levels

Allow corporates to vary rates on perpetual membership capital to help build capital, then reward owners for financial performance of the corporate once minimum capital targets are met

Allow limited portability of membership by permitting a credit union to sell their perpetual capital in one corporate and join another corporate (contributing perpetual capital to the new corporate). Include restrictions required for the perpetual capital to qualify as GAAP Tier 1 capital. Require Board of Director approval so that a corporate does not experience a catastrophic loss of capital if a group of credit unions changed during the same period. Govern unforeseen occurrences by requiring NCUA approval of such migrations

Enable corporates to distribute other corporates' investment and lending products, for a fee. This would allow credit unions to diversify investments and liquidity sources across multiple corporates without fostering the fierce competition that currently exists

Allow credit unions to directly diversify their investments and liquidity sources by establishing one or more relationships with "secondary" corporates. The credit union would be allowed to obtain select services (term investments, term loans) by depositing three-year term membership capital shares in proportion with the level of services utilized. Pricing of these products would be no better than what a "primary" member could obtain (to reduce competition for diversification services)

### **Expanded Investment Authority**

No Comment

### **Structure: Two-Tiered System**

**The Corporate System should be collapsed into a single tier** – Many functions are replicated at the two tiers creating significant inefficiencies. Capital accumulation at both tiers is not feasible given current low margins and ROAs, prospective losses, and anticipated increases in capital requirements across the entire financial services industry. To gain efficiencies, improve margins, and accelerate accumulation of capital, one tier should be eliminated.

**Single corporate and multiple corporate models are both viable** – 1) A single national corporate would provide the greatest operating efficiency and can be more responsive to industry opportunities and challenges. However, all risk would be concentrated into a single organization. It is likely the percentage of credit union investable funds and borrowing currently held in corporates would drop as members would not have the option of diversifying across multiple corporates. 2) The multi-corporate options would spread risk but would also be less efficient. Under the current models, the fewer the corporates, the more efficient the network would become. These inefficiencies may be tempered somewhat if the level of competition was dramatically reduced and cooperation (e.g. consolidation of common functions such as payments, core technology, and innovation) was dramatically increased. Solutions for enabling credit union diversification of investments and borrowing across multiple corporates must be implemented to ensure that the network retains credit union business, increasing earnings and capital accumulation.

**Elimination of a tier will spur consolidation of corporates and common corporate functions** – Elimination of one tier will require all corporates to have the capability to effectively manage its investments, liquidity, risk and other functions. The more the corporates cooperate to create efficiencies (e.g. consolidate payments, share technology, cooperatively innovate), the greater the viability of the existing corporates. Ultimately, the marketplace, the level of cooperation, and the expenses to operate in a safe and sound manner will determine the number of corporate credit unions.

**There is need for one or more central CUSOs** – Whatever the number of corporates, certain functions should be consolidated for efficiency and to enable opportunity. At a minimum, this entails centralized payments, technology (core account processing, common

electronic delivery channel), and innovation functions. Other opportunities to centralize functions for scale include risk modeling, member call centers, business lending, health banking and brokerage services. This action would require strong regulation and supervision of CUSOs by NCUA.

### **Core Capital**

**Core capital definition should be GAAP Tier 1 capital** – Under this definition, the corporates' retained and undivided earnings (RUDE) and perpetual paid-in capital (PIC) would qualify. Corporates' term PIC (representing the vast majority of all PIC outstanding) would not qualify.

**Core capital requirement of 4% by end of 2010** – To build sufficient capital, the Corporate Network must be consolidated for efficiency. This will require several years. A 4% core capital target is achievable if corporates deleverage balance sheets, shrink member deposits, and obtain perpetual member-contributed capital.

**Future core capital requirement of 6%** – Higher core capital is needed to accommodate changing views of risk and meet expectations of industry stakeholders. The ability for the Corporate Network to build to 6% core capital will depend upon efficiencies gained through consolidation, and its ability to demonstrate enough value to members so they will contribute perpetual capital. Setting a clear vision will serve as a catalyst for consolidation. Without a higher expectation for core capital, fewer hard decisions will be made.

**RUDE must be sufficient to accommodate growth** – Member-contributed Tier 1 capital must be considered core capital in all respects. Discounting the value in corporate regulation is inconsistent with the GAAP definition of Tier 1 capital. However, RUDE must be sufficient to accommodate balance sheet growth, whether caused by economic cycles or increases in market share. Each corporate should be required to maintain a capital plan that models growth scenarios and maintains RUDE sufficient to accommodate such growth.

**Actual capital divided by 12-month DANA is appropriate** – The current requirement, actual capital divided by 12-month daily average net assets, accommodates fluctuations in assets due to seasonality. This will continue to be an appropriate method for measuring capital.

**Retain existing membership capital shares (MCS) until core capital is 6%** – The existing membership capital shares are needed given the corporates' current capital levels. Once a corporate reaches this capital level, membership capital shares may no longer be needed and might be returned to members (without a notice period). Allow the corporate the option of maintaining this structure to augment core capital in order to fund additional products and services. Govern unforeseen circumstances by requiring NCUA approval of MCS distributions.

Permissible Investments

No Comment

## **Credit Risk Management**

**Existing practices proved too reliant on ratings** – Corporate regulation and credit risk practices used rating agencies as the predominant metric for evaluation of credit risk associated with investment securities. While this has been historically reliable, it proved inadequate throughout the current credit crisis, providing a false sense of confidence as ratings volatility and downward migrations have reached historic levels. Ratings, while predominant, were not the only metrics used to evaluate investment securities. Additional input included rating agency comments, analysis from other providers (brokers, analysts, and industry sources), internal modeling, historical performance of asset types, and forward looking reviews by industry experts.

**Fix the rating agencies** – The financial services industry must require significant improvement in the rating agencies' performance. The agencies must maintain their independence and minimize conflicts of interest between agencies and issuers.

**Require ratings from multiple agencies** – Improve practices by obtaining ratings from multiple agencies utilizing, or assigning greater weight to, the lowest rating. However, the industry should be cautious that obtaining multiple ratings can also provide a false sense of security as current credit market dislocations were not accurately assessed by any of the rating agencies. We can hope that the use of multiple rating agencies in the future will prove more effective as the rating agencies revise their modeling, internal governance, and accountability to both investors and regulatory bodies.

**Establish a regulatory review process for new security types** – Obtain regulatory review of the appropriateness of new security types as they are created as well as existing types as the industry evolves. An alternative is to obtain an external review of any new asset class by a qualified external third party with appropriate levels of expertise and infrastructure to assess risk effectively.

**Limit duration or cash flow structures** – Establish rules to limit cash flows and duration of investment securities with the intent to minimize the potential impact of deterioration of credit spreads (as we have witnessed over the past 24 months).

**Better defined and controlled concentration limits** – New limits and controls are essential. However, there are prerequisites to implementing effective limits and controls. While “Obligor” is a well defined term, “sector” is not. Each investor has its own definition of sectors. A standard definition of sectors must be created and applied consistently across all corporates. Governance of this definition must be nimble enough to accommodate the pace of change in the industry (e.g. new asset classes). It is not feasible for this to be coded in regulation but should be governed by other agency guidance.

**Target optimum, not maximum diversification** – Diversification needs to be the hallmark of new guidance for corporates going forward. However, care must be taken to avoid

unintended consequences of increasing risk (by tapping more risky sectors or accepting an inadequate risk/return ratio by over-diversification).

**Establish independent evaluations of credit risk portfolios** – These reviews would be conducted by qualified third parties with provider and statement-of-work approved by the regulators in advance. The costs of such reviews must be appropriately balanced with the risks and costs.

**Test sensitivities to credit spread widening** – Credit spread widening should be included as one of the risk parameters in the review of credit risk, and should be included in the reviews of interest rate and liquidity risk.

**Change third-party reviewers every three years** – Require corporates to change providers of external reviews periodically. This will ensure that the corporates' view of these risk categories are appropriate with current risk methodologies, new developments, and consistent with industry best practices.

#### **Asset Liability Management**

**No Comment**

#### **Corporate Governance**

**No Comment**

#### **Other issues**

***Retain Office of Corporate Credit Unions (OCCU) or equivalent function*** – The NCUA has indicated that it is considering elimination of the Office of Corporate Credit Unions (OCCU). Members United believes that the agency should retain OCCU or an equivalent function. Corporate credit unions are unique in their purpose, balance sheet composition, product offerings, risk profile, etc. This requires regulation, guidance, and examination processes that are tailored to corporates.